

MEMORANDUM OF LAW

DATE: August 10, 1992

TO: F.D. Schlesinger, Clean Water Program Director

FROM: City Attorney

SUBJECT: Use of Water Utility Land for Environmental Mitigation

BACKGROUND

You have asked this office several questions relating to the possible use of Water Utility land for the environmental mitigation of Clean Water Program projects. You note that the Joint Environmental Impact Report/Environmental Impact Statement ("EIR/EIS") for Secondary Treatment and Associated Sludge Processing Facilities certified by the City Council in April 1991 committed to the development of a Multiple Species Conservation Program ("MSCP") and to the natural preservation of certain Water Utility lands. These lands include Lake Hodges, San Vicente, Otay, and Marron Valley, which are all existing or potential reservoir sites. The series of questions is as follows:

QUESTIONS

1. How is the transfer of these lands best accomplished, keeping in mind ratepayer equity and the proposed transfer of City assets to the San Diego Area Wastewater Management District ("District")?
2. Has the City paid for these lands once, billing the water system ratepayers?
3. Do the sewer ratepayers, many of whom are the same as the water ratepayers, pay again?
4. What is the best timing for the transfer of property in order to accomplish the smoothest transition from City to District?
5. If the Clean Water Program stays in the City, would a transfer still be necessary?

CONCLUSIONS

1. The land need not be transferred to form part of the MSCP, but only encumbered by its dedication to habitat preserve use. For both practical and legal reasons, the sewer utility would be required to compensate the Water Utility for such an

encumbrance, except for mitigation of those projects related to the development of reclaimed water supply. Compensation would also be legally required if the sewer utility is under the jurisdiction of the proposed District, again except for reclaimed water facilities.

2. City reservoir sites were purchased with water revenues, and are now owned by the Water Utility.

3. The assets of the Water Utility are separate and distinct from assets of the sewer utility because those respective assets were acquired from different revenue funds. Although many ratepayers pay into both funds, this is not universally or proportionately true, and thus there is no extensional equivalence between the two funds. Each fund has a separate legal purpose, and the fiscal identity of the assets purchased from those funds must be preserved. This is required by San Diego City Charter ("Charter") section 53 which governs the Water Utility, as well as by Charter sections 90.1 and 90.2 where bonds have been issued to finance water or sewer works.

4. Because compensation to the Water Utility will be necessary whether the sewer utility is operated by either the City or the District, the timing of the proposed transfer or use encumbrance seems relatively unimportant, as payment will be made from sewer revenues regardless of whether those revenues are collected and paid by the City or the District.

5. Same conclusion as No. 4.

ANALYSIS

A. Dedication of Land to MSCP

Your questions utilize the term "transfer," so at the outset it should be clarified what is meant by this. Specifically, it should be noted that environmental mitigation need not entail actual transfer of fee title, but only dedication of the land to species habitat preservation use. Of course, such a dedication would have to satisfy the regulating agencies. At the federal level these are the U.S. Environmental Protection Agency and the U.S. Fish and Wildlife Service, which together are charged with the administration of the National Environmental Policy Act and the Endangered Species Act. At the State level, the California Department of Fish and Game and the Regional Water Quality Control Board will administer the California Environmental Quality Act and California Endangered Species Act for Clean Water Program Projects. The collective satisfaction of these agencies likely will require the recordation of covenants of encumbrance which run with the land as long as the projects to be mitigated continue to impact the environment. Title to this land need not be transferred, but use encumbrances likely would

diminish the value of the land to some estimable extent, and require compensation as explained below.

B. The Water Utility Must be Compensated for Disposal of Interest in its Assets

On several past occasions, this office has concluded that San Diego City Charter section 53 requires full value compensation to the Water Utility for the disposition or use of any of its assets. See City Attorney Opinions 80-8 and 80-6, attached. The pertinent part of Charter section 53 reads:

All revenues of the Water Utility shall be deposited in a Water Utility Fund Only after providing the requirements for Water Utility purposes . . . may the City Council in the annual appropriation ordinance provide for the transfer to the General Fund of the City any excess revenues accruing to the Water Utility Fund. Such revenue transferred to the General Fund shall be available thereafter for use for any legal City purpose.

The purpose of this law is to preserve the Water Utility's integrity as a self-sustaining, financially autonomous institution within the City's government. As noted in the previous opinions, the above-quoted revenue deposit requirement of Charter section 53 precludes disposition of Water Utility assets to the City's General Fund uses unless all of the requirements of the Water Utility have first been met.

We believe that it would be unreasonable to determine that certain and particular Water Utility parcels are "surplus" in view of the needs of the Water Utility, which operates in a semi-arid region where demand for water has almost always eclipsed supply. The Water Utility's requirements are listed in Charter section 53, and include the costs of operation and maintenance, replacements, betterments and expansion of facilities, payments necessary for obtaining Colorado River water, other contractual obligations, and reserves for future water purchases. In view of these needs, which to reason seem ever-present and always beyond possibility of complete fulfillment, the revenues and assets of the Water Utility cannot reasonably be deemed surplus so as to be put to other purposes without full compensation to the Water Utility Fund.

Beyond the conditions of Charter section 53, there exist other limitations on asset disposition where bonds have been

issued to finance development of the Water Utility. Charter sections 90.1 and 90.2 deal respectively with waterworks and sewer bonds, and each of those provisions requires that the identity of revenues be preserved in the Water Revenue Fund or the Sewer Revenue Fund, according to origin. Only the costs of operating and maintaining the respective water or sewer utilities would take precedence in these funds over the payment of principal and interest on issued bonds. Moreover, as noted in Opinion 80-6, the bonds themselves contain covenants that restrict the disposition of revenues or assets by requiring deposit to the relevant Revenue Fund to provide security on bond investments.

With regard to the reservoir sites presently at issue, these were either subsumed within the Water Utility upon its creation in 1931 (when Charter section 53 was adopted), or they were purchased later with water revenues, or with bond proceeds refunded by water revenues. At this time there remain no outstanding waterworks bonds issued under Charter section 90.1, given that the last of these bonds were retired as of June 30, 1991. Water Utilities Department Annual Financial Report, Fiscal Year 1991, Exhibit A page 27. Thus, there are no present restraints on the reservoir properties which are related to bonds, but nonetheless, any encumbrance or disposition of these properties still would require full value compensation. To repeat the conclusion reached in Opinion 80-8: Charter section 53 "requires that any change in use or disposition of surplus real property carried on the accounts of the City of San Diego Water Utility equally benefit the accounts of the Water Utility as nearly as possible." This holds true "irrespective of bond covenants or restrictions and regardless of the pressure from special interest groups" 1 Op. City Att'y 87 (1980).

C. Historical Context: Relation of the Sewerage System to the Water Utilities Department

Your questions allude to the relationship between the water and sewer utilities, and ask whether there may be a fiscal nexus between the two, since both are presently part of the Water Utilities Department, and both seem to have the same customers. To answer this inquiry, it is helpful to look at the history of the water and sewer functions, which reflects a clear distinction and separation.

Very importantly, the "Water Utility" that was established by Charter section 53 in 1931 was for many years, and still is, exclusively concerned with matters of water supply, treatment, and distribution. In 1931 the sewerage system was operated separately, and was managed under the jurisdiction of the former

Division of Sewers, which was dissolved by the repeal of Charter section 48 in 1953. After that, the sewerage utility was administered by the former Department of Public Works pursuant to Charter section 46.

Charter section 46, among others, was repealed by Proposition R of the 1963 election, about the same time the Metropolitan Wastewater System became operational. Proposition R also amended Charter section 53 to change the name "Water Department" to "Water Utility," and moreover, added Charter section 26.1 requiring the City Council to provide certain public services in lieu of the repealed Charter sections. The purpose for the repeal of those Charter sections dealing with Public Services, including section 46, was to place administration of those services under the immediate authority of the City Council (rather than the Charter) so as to achieve better administrative efficiency. Thus, the sewerage utility became directly governed by the ordinances of the City Council, which have long since established a Sewer Revenue Fund (now SDMC section 64.0403), and have given the City Manager administrative authority over sewerage operations. (Now SDMC section 64.0300.) Pursuant to that authority, the City Manager has delegated (SDMC section 22.0201) to the Water Utilities Department the responsibility of managing the sewerage system, and that operation has always been financially distinguished from the Water Utility functions described by Charter section 53. In fact, the 1963 ballot argument for Proposition R explained that the intent to repeal Charter section 46 was purely for the sake of administrative efficiency, and that consolidation of utility services under the City Council and Manager's authority would not affect the financial independence of the (then named) Water Department. In part, the argument read:

The Charter Review Committee again is attempting to provide for flexibility and economy in administration by removing reference to a Water Department and putting the authority to supervise the water utility in the hands of the Manager where actual supervision now rests. It is not intended to in any way change the operation or financial provisions of the present Water Department, or any element thereof. The amendment is largely concerned with improvement and clarification of

Charter language. (Emphasis added.)

Therefore, it is quite clear that today's Water Utilities Department has two separate and distinct functions, water services and sewer services, and that the financial distinction of these functions is legally mandatory and practically necessary. Although Proposition R permitted administration of the sewerage system by the Water Utilities Department, it did not amend Charter section 53 so as to permit commingling of the assets of the Water Utility with those of the sewerage system.

To extend this analysis, the Clean Water Program was also created as a subdivision of the Water Utilities Department by Ordinance No. O-17470 (New Series) on May 22, 1990. It is significant to note that the ordinance also provided for a separate director to manage the Clean Water Program. Since the Clean Water Program is in fact primarily concerned with sewage collection and treatment issues, it is certain that it would indeed have to compensate the Water Utility for the use of reservoir properties.^F

"Treatment" may include water reclamation and the development of a usable supply of reclaimed water. See section D of this Memorandum of Law for a different analysis where water reclamation projects are at issue.

Although the Clean Water Program is presently a technical component of the Water Utilities Department, it is not part of the Water Utility described by Charter section 53. Rather, it is an extension of the sewerage utility that is one of the Public Services administered by the City Council pursuant to Charter section 26.1.

Still, you are correct to observe that many water revenues derive from the same persons who pay for sewer service. However, this is not always the case, and the fact that water and sewer revenues may have a common origin does not mean that those revenues share a common legal purpose. As explained above, the water and sewer utilities have separate functions, and revenues received by each utility, as well as assets held, must be maintained for those separate objectives. This is true regardless whether bonds have been issued to finance the utilities, but bonding even further strengthens the legal principle requiring separation.

D. Different Analysis for Reclaimed Water Projects

So far we have discussed the historical and legal separation of the water and sewer utilities, but with the advent of water reclamation as a viable and practical approach to both sewer and water problems, distinct consideration can be given.

Many projects of the Clean Water Program relate to the development of a reclaimed water supply, and thus a different analysis may be applied to those projects.

Referring again to Charter section 53, we recall that the legal objectives of the Water Utility include, among other things, "reserves for expansion of future water utility plant;" and "reserves for future water purchases." The essence of these objectives, we believe, is simply a dedication of the Water Utility's assets to the singular purpose of developing a water supply which will meet the needs of the citizens of San Diego. To the extent that usable reclaimed water will be made available to San Diego citizens by virtue of Clean Water Program projects, the accounts of the Water Utility are benefitted. Thus, for the purpose of mitigating the environmental impacts of projects which will produce usable reclaimed water, we are of the opinion that Water Utility lands may legally be used without requiring full compensation. This is because the development of a reclaimed water supply is within the legal ambit of the Water Utility's objectives.

Beyond this legal conclusion, however, are practical considerations. It would fall to the discretion of the City Council to determine whether encumbrance of the Water Utility's reservoir sites to mitigate environmental impacts of reclamation projects is within the best interests of the Water Utility.

E. Proposed Transfer to Special Act District

The foregoing analyses are entirely transferable to your questions about the proposed Special Act District. If the sewerage utility were operated by the District, the same sewer revenues now collected by the City would then be collected by the District, and used in part for environmental mitigation of its projects. This might mean paying the City's Water Utility for the use of its reservoir sites, if the City Council and Manager are amenable to the idea. Likewise, if the water reclamation projects are performed by the District, the Water Utility of the City would still benefit from the availability of reclaimed water. Thus the City Council and Manager could legally entertain the policy decision of whether to mitigate impacts of those District reclamation projects with Water Utility land, in light of the benefit conferred upon the Water Utility by the increased availability of usable water.

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By

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Attachments

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